No. 13153

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,
Appellant,

vs.

HENRY S. WAECHTER, HAZEL MILLER and WILLIAM T. WAECHTER, Co-Executors of the Estate of May Florence Waechter, Deceased,
Appellees.

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON NORTHERN DIVISION

HONORABLE LEON R. YANKWICH, *Judge*

BRIEF FOR THE UNITED STATES

ELLIS N. SLACK,
Acting Assistant Attorney General

MELVA M. GRANEY,
Special Assistant to the Attorney General.

J. CHARLES DENNIS,
United States Attorney.

OFFICE AND POST OFFICE ADDRESS:
1017 UNITED STATES COURT HOUSE
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OPINION BELOW

The opinion of the District Court (R. 23-28) is reported at 98 F. Supp. 960.

JURISDICTION

The plaintiff-appellees, who are the duly appointed, acting and qualified executors of the estate

of May Florence Waechter (R. 15), deceased, filed an estate tax return on behalf of the estate on March 22, 1948 (R. 15, 16). In the return they reported a gross estate of $77,480.25, which included one-half of the cash surrender value of certain insurance policies upon the life of the decedent's surviving spouse, Henry Waechter (R. 16, 17-18), and an estate tax liability of $850.62, which they paid (R. 17). Subsequently the executors paid a deficiency of $1,680.04 which was assessed by reason of matters not in issue here (R. 18). On August 24, 1949, they filed a timely claim for refund of $1,459.33 based upon the alleged overpayment of estate tax in the amount due to inclusion in the decedent's gross estate of one-half of the cash surrender value of the insurance policies above-mentioned. (R. 18). Six months elapsed during which the Commissioner neither allowed nor disallowed the claim (R. 14) and this suit was instituted on April 6, 1950 (R. 12), which was within the time provided by Section 3772 (a) (2) of the Internal Revenue Code. The District Court had jurisdiction of the case under 28 U.S.C. Sections 1340 and 1346. Judgment for plaintiff-appellee was entered on August 8, 1951. (R. 31-32.) Notice of appeal by the United States was filed on October 3, 1951 (R. 32), and properly invoked the jurisdiction of this Court under 28 U.S.C., Section 1291.

QUESTION PRESENTED

Whether the District Court erred in holding that Section 811 (e)(2) of the Internal Revenue Code does not require the inclusion in the decedent's gross estate of any part of the cash surrender value of the insurance policies on the life of the decedent's husband on which the premiums had been paid with community funds.

STATUTES INVOLVED

Internal Revenue Code:

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States —

* * *

(e) [as amended by Sec. 402 (b)(1) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Joint and Community Interests.* —

* * *

(2) [as added by Sec. 402 (b)(2) of the Revenue Act of 1942, supra] *Community Interests.*—To the extent of the interest therein held as community property by the decedent and surviving spouse under the law of any State, Territory, or possession of the United States, or any foreign country, except such part thereof as may be shown to have been received as compensation for personal services

actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse. In no case shall such interest included in the gross estate of the decedent be less than the value of such part of the community property as was subject to the decedent's power of testamentary disposition.

* * *

(26 U.S.C. 1946 ed., Sec. 811.)

3 Remington's Revised Statutes of Washington Annotated:

Sec. 1342. *Descent of community property.* Upon the death of either husband or wife, one-half of the community property shall go to the survivor, subject to the community debts, and the other half shall be subject to the testamentary disposition of the deceased husband or wife, subject also to the community debts. In case no testamentary disposition shall have been made by the deceased husband or wife of his or her half of the community property, it shall descend equally to the legitimate issue of his, her or their bodies. If there be no issue of said deceased living, or none of their representatives living, then the said community property shall all pass to the survivors to the exclusion of collateral heirs, subject to the community debts, the family allowance, and the charges and expenses of administration.

8 Remington's Revised Statutes of Washington Annotated:

Sec. 6892. *Community property defined — Husband's control of personalty.* Property, not

acquired or owned as prescribed in the next two preceding sections, acquired after marriage by either husband or wife, or both, is community property. The husband shall have the management and control of community personal property, with a like power of disposition as he has of his separate personal property, except he shall not devise by will more than one-half thereof.

STATEMENT

The parties stipulated in the District Court that the stipulated facts shall take the place of findings of fact. (R. 29.) The stipulated facts (R. 15-18) may be stated as follows:

The decedent, May Florence Waechter, died on February 20, 1947. (R. 16.)

During the married life of the decedent and her husband, Henry Waechter, the following insurance policies were carried upon the life of Henry Waechter (R. 17):

Amount of Policy	Name of Company	No. of Policy	Date of Policy	Beneficiary	Cash Value as of 2/20/47
$ 3,000.00	Equitable Life Co.	1196536	1/14/03	May F. Waechter if living, but if not, to William G. Waechter and Hazel B. Miller equally, or survivor, and should neither survive, to assured's estate.....	$ 2,420.00
$25,000.00	New York Life Co.	6320634	8/ 6/18	May F. Waechter and after death to Hazel B. Miller and Gerry Waechter, share and share alike, or survivor....	$15,244.75
$ 4,000.00	Equitable Life Co.	1337670	5/11/04	May F. Waechter or estate of insured	$ 3,620.00
				Total Cash Surrender Value.....	$21,284.75

The premiums on these policies had been paid with community funds down to the date of the decedent's death and on that date the policies were in

full force and effect and had not been surrendered, nor had any payments been received on account of the cash surrender value of the policies. (R. 17.)

In the estate tax return they filed on behalf of the estate of the decedent, the executors of the estate included one-half of the cash surrender value of the policies in the decedent's gross estate (R. 17-18) but subsequently they filed claim for refund and instituted this suit for refund of the tax paid on the one-half of the cash surrender value of the policies (R. 18, 20-21). The United States defended the suit for refund on the ground that one-half of the cash surrender value of the policies is includible in the decedent's gross estate under Section 811 (e)(2) of the Internal Revenue Code. (R. 22.) The District Court held to the contrary (R. 23-28) and entered judgment for the plaintiff-appellees (R. 31-32).

STATEMENT OF POINTS TO BE URGED

The appellant's statement of points is contained in the record at pages 36-37. It is the Commissioner's position that the District Court erred in holding that one-half the cash surrender value of the life insurance policies on the life of the decedent's husband, on which the premiums had been paid with community funds, is not includible in the decedent's gross estate for federal estate tax purposes.

SUMMARY OF ARGUMENT

Community funds were used to pay the premiums on the insurance policies on the life of the decedent's husband. The policies were accordingly community property under the law of the State of Washington. Section 811 (e)(2) of the Internal Revenue Code, applicable to the estate of the instant decedent, requires the inclusion in a decedent's gross estate of the value of property held as community property by the decedent and surviving spouse, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse. The stipulated facts contain no statement to afford a basis for such an exclusion, but the executors of the decedent's estate included only one-half of the value of the policies (one-half of their cash surrender value) in the decedent's gross estate and are here seeking to recover only the tax paid by reason of such inclusion. Since the policies were held by the decedent and her surviving husband as community property, one-half of the cash surrender value of the policies was properly included in the decedent's gross estate under Section 811 (e)(2).

The District Court's decision to the contrary was

based upon the erroneous assumption that estate tax liability does not attach unless an estate passed by will or inheritance upon the decedent's death. Concededly, one-half of the cash surrender value of the policies was not property which passed by will or inheritance upon the decedent's death. However, that is immaterial for federal estate tax purposes in general and under Section 811 (e)(2) in particular. Upon the decedent's death someone, presumably her husband, received the decedent's interest in the policies, that is, the right, upon surrender of the policies, to receive the one-half of the cash surrender value which would have belonged to the decedent but for her death. The decedent's death effected a termination of her interest in the policies and a change in legal and economic relationships with respect to the policies. That is sufficient to support taxability under *Fernandez v. Wiener*, 326 U.S. 340, rehearing denied, 327 U.S. 814, which sustained the constitutionality of Section 811 (e)(2).

ARGUMENT

THE DISTRICT COURT ERRED IN HOLDING THAT SECTION 811 (e)(2) OF THE INTERNAL REVENUE CODE DOES NOT REQUIRE THE INCLUSION IN THE DECEDENT'S GROSS ESTATE OF ANY PART OF THE CASH SURRENDER VALUE OF THE INSURANCE POLICIES ON THE LIFE OF THE DECEDENT'S HUSBAND ON WHICH THE PREMIUMS HAD BEEN PAID WITH COMMUNITY FUNDS.

Section 811 (e)(2) of the Internal Revenue Code, *supra*, which is applicable to the estate of the decedent, May Florence Waechter,[1] requires the inclusion in the decedent's gross estate of all property —

> to the extent of the interest therein held as community property by the decedent and surviving spouse under the law of any State, * * * except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or

[1] Section 811 (e)(2), together, with other estate tax provisions relating to community property, was repealed by Section 351 (a) of the Revenue Act of 1948, c. 168, 62 Stat. 110, effective with respect to estates of decedents dying after December 31, 1947, but the instant decedent died on February 20, 1947. Since the repeal of Section 811 (e)(2), community property has been includible in a decedent's gross estate only to the extent it is includible therein under Section 811 (a) which relates to the decedent's interest in property.

> from separate property of the surviving spouse. In no case shall such interest included in the gross estate of the decedent be less than the value of such part of the community property as was subject to the decedent's power of testamentary disposition.

The District Court held that this section does not require the inclusion in the decedent's gross estate of any part of the cash surrender value of the insurance policies on the life of the decedent's husband on which the premiums had been paid with community funds. In so holding the District Court clearly erred, as will be seen.

The District Court did not deny and there can be no doubt that, since the premiums on the insurance policies were paid with community funds, the policies were held as community property by the decedent and her surviving spouse. See Section 6892 of 8 Remington's Revised Statutes of Washington Annotated, *supra; Lang v. Commissioner*, 304 U.S. 264; *Occidental Life Ins. Co. v. Powers*, 192 Wash. 475; *King v. Prudential Insurance Co.*, 13 Wash. (2d) 414; *In re Towey's Estate*, 22 Wash. (2d) 212; *Small v. Bartyzel*, 27 Wash. 176; *Wilson v. Wilson*, 212 P. (2d) 1022 (Wash.); cf. *Poe v. Seaborn*, 282 U.S. 101; *De Lappe v. Commissioner*, 113 F. (2d) 48 (C.A. 5th); *Graham v. Commissioner*, 95 F. (2d) 174 (C.A. 9th); *Womack v. Womack*, 141 Tex. 299. In

the State of Washington, when community funds are used to pay the premiums on an insurance policy on the husband's life, the husband can give away only one-half of the proceeds of the policy. *Wilson v. Wilson, supra.*. The proceeds of the policy are community property, even when payable to the husband's estate, unless the husband has obtained the wife's consent to the designation or change of beneficiary to someone other than his estate or unless the wife is designated as the sole beneficiary. *Occidental Life Ins. Co. v. Powers, supra; King v. Prudential Insurance Co., supra; In re Towey's Estate, supra.* During the life of the insured, insurance forms a reserve to be drawn upon in times of stress *(Massachusetts Mutual Life Ins. Co. v. Bank of California,* 187 Wash. 565) and, as the Supreme Court of Washington stated in *Occidental Life Ins. Co. v. Powers, supra,* p. 484—

> In this state, insurance or the proceeds of insurance are not mere expectancies or choses in action, but are property; and if the premiums are paid by the assets of the community, they constitute community property.

If policies on which the premiums have been paid with community funds are cash surrendered, the cash surrender value is community property, just as it was held in *Jones v. Davis,* 15 Wash. (2d) 567, that

any proceeds obtained as a loan on such a policy are community property.

The fact that the instant insurance policies constituted property "held as community property by the decedent and surviving spouse" *per se* precludes recovery by the decedent's estate of the tax paid on one-half the value of the policies, that is, on one-half of the cash surrender value. Actually, Section 811 (e)(2) requires the inclusion in the decedent's gross estate of the entire value of property held as community property by the decedent and her surviving spouse, except such part of the value—

> as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse. * * *

The stipulated facts contain no statements to furnish a basis for an exclusion on either of those grounds and, accordingly, on the basis of the stipulated facts the entire cash surrender value of the policies would be includible in the decedent's gross estate under Section 811 (e)(2). However, the executors of the estate included only one-half of the cash surrender value of the policies in the decedent's gross estate and it is only the tax paid on that one-half

which the estate is seeking to recover in this proceeding.

The District Court's decision, holding that the estate is entitled to recover, is based upon the erroneous assumption that federal estate tax liability does not attach unless an "estate" passes *by will or inheritance* upon the decedent's death. Concededly, in *In re Knight's Estate*, 31 Wash. (2d) 813, where community funds had been used to pay the premiums on insurance policies on the life of the husband, it was held that the cash surrender value of the policies was not property which was includible in the decedent-wife's estate for state inheritance tax purposes as being property which passed by will or inheritance. But that fact is of no importance for federal estate tax purposes under Section 811 (e)(2).

Section 811 (e)(2) does not by its terms apply only to community property which passes upon the decedent's death by will or inheritance, nor can it properly be so interpreted. The statute unqualifiedly requires the inclusion in a decedent's gross estate of the value of property "held as community property by the decedent and surviving spouse", except such part thereof as may be shown to have been received as compensation for personal services actually performed by the surviving spouse or derived originally

from such compensation or from separate property of the surviving spouse. The statute further provides that in no case shall such interest included in the gross estate of the decedent be less than the value of such part of the community property as was subject to the decedent's power of testamentary disposition, but this merely qualifies the previously stated exclusion of such part of the value shown to be attributable to the separate property of the surviving spouse or to compensation for services actually performed by the surviving spouse. In the absence of a showing that some part of the property was attributable to the separate property of the surviving spouse or to compensation for services actually performed by the surviving spouse, the entire value of the community property, and thus the value of the share of the surviving spouse, is includible in the decedent's gross estate *despite the fact that the surviving spouse's share does not pass by will or inheritance at the decedent's death or even pass to anyone in any manner at that time. Fernandez v. Wiener,* 326 U.S. 340, rehearing denied, 327 U.S. 814, so applies the statute. The fact that Section 811 (e)(2) is but a part of Section 811 (e), entitled "Joint and Community Interests", also indicates that it was not intended to be limited in its application to community

property which passes by will or inheritance at the decedent's death. The first paragraph of Section 811 (e) (Section 811 (e)(1)) relates to interests held as joint tenants and as tenants by the entirety and requires the inclusion in a decedent's gross estate of property which definitely does not pass by will or inheritance.

The District Court was in error in stating (R. 26) that "To be taxable, a transfer of an estate must occur". That is shown by the fact that Section 811 (e)(2), in taxing one spouse on the value of the other spouse's share of community property, is not based on the transfer of an "estate" or of property but, as so applied, was nevertheless held to be constitutional in *Fernandez v. Wiener, supra.* The decision in that case discusses at great length the scope of the Congressional power to impose an estate tax. Among other things, the Supreme Court there stated (pp. 352, 356-357, 358):

> It is true that the estate tax as originally devised and constitutionally supported was a tax upon transfers. * * * But the power of Congress to impose death taxes is not limited to the taxation of transfers at death. It extends to the creation, exercise, acquisition, or relinquishment of any power of legal privilege which is incident to the ownership of property, and when any of these is occasioned by death, it may as readily

> be the subject of the federal tax as the transfer of the property at death. * * *
>
> * * *
>
> * * * It is enough that death brings about changes in the legal and economic relationships to the property taxed, and the earlier certainty that those changes would occur does not impair the legislative power to recognize them, and to levy a tax on the happening of the event which was their generating source.
>
> * * *
>
> We find no basis for the contention that the tax is arbitrary and capricious because it taxes transfers at death and also the shifting at death of particular incidents of property. Congress is free to tax either or both, and here it has taxed both, as it may constitutionally do, in order to accomplish "the purposes and policy of taxation" to protect the revenue and avoid an unequal distribution of the tax burden.' * * *

There can, therefore, be no question that Section 811 (e)(2) requires the inclusion in the decedent's gross estate of at least the one-half of the cash surrender value involved here. As we have shown, the policies are held by the decedent and her surviving husband as community property, which is all the statute requires and is sufficient to support taxability. While the decedent's death did not effect a transfer of one-half the cash surrender value of the policies *to her heirs or legatees*, it did necessarily effect a transfer to someone of her community interest in the policies (the value of which was one-half of their cash

surrender value), although not a transfer of money in the amount of one-half of the cash surrender value. The policies were in full force and effect at the decedent's death and someone, presumably the decedent's husband, received the right, upon surrender of the policies, to receive the one-half of the cash surrender value which would have belonged to the decedent but for her death. Actual transfer of one-half of the cash surrender value was unnecessary to support taxability; under *Fernandez v. Wiener, supra,* it is sufficient that the decedent's death effected a termination of her interest in, and a change in legal and economic relationship with respect to, the policies.[2]

The District Court was of course in error in giving consideration (R. 26-27) to the fact that the executors of the decedent's estate could not reduce one-half of the cash surrender value of the policies to their possession on behalf of the decedent's estate. Section 811 of the Code contains a number of provisions requiring the inclusion in a decedent's gross estate of the value of property which cannot be reduced to the possession of the executors and it is no barrier to application of any of those statutes, in-

[2] It is pertinent to note that the decedent was a beneficiary under each of the policies and that her death therefore also effected a change in legal and economic relationships with respect to the future proceeds of the policies.

cluding Section 811 (e)(2), that the executors are nevertheless under a duty to include the value of such property in the decedent's gross estate in filing an estate tax return on behalf of the estate.

Taxpayers may contend that Section 811 (g) of the Code, in providing for the inclusion of certain proceeds of insurance in a decedent's estate, is exclusive with respect to life insurance and that if an insurance policy cannot be included in the gross estate under that section it cannot be included in the gross estate under some other section. The contention is clearly untenable. That is definitely established by the House Ways and Means Committee Report on the Revenue Act of 1942, which amended Section 811 (g). There the Committee stated (H. Rep. No. 2333, 77th Cong., 2d Sess., p. 163 (1942-2 Cum. Bull. 372, 492)):

> This section, like the present provisions in Section 811 (g), does not constitute the only section under which life insurance is includible in the gross estate. * * *

For cases where it has been held that life insurance was includible in an estate under sections of the Code other than Section 811 (g), see *Vanderlip v. Commissioner*, 155 F. (2d) 152 (C.A. 2d), certiorari denied, 329 U.S. 728, and *Davidson's Estate v. Commissioner*, 158 F. (2d) 239 (C.A. 10th).

CONCLUSION

The decision of the District Court is incorrect and should be reversed.

Respectfully submitted,

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January, 1952.